I very much welcome the Finance Committee’s work on this important topic, including gathering a wide range of oral and written evidence from witnesses during the enquiry. I was pleased to have the opportunity to offer evidence to the Committee’s hearing on 8 January, and was very interested to read the report and recommendations published on 7 February.

I now enclose the Scottish Government’s response to the Committee’s report. I would be very happy to discuss the response when I attend the Committee’s hearing on 7 May to give evidence on the annual report on progress with implementing the financial provisions of the Scotland Act.
The Scottish Government welcomes the Finance Committee Report, published on 7 February 2014, on proposals for a Scottish Fiscal Commission. The report drew on a range of expert evidence and in the view of the Scottish Government makes a valuable contribution to consideration of next steps in establishing a Scottish Fiscal Commission to scrutinise and provide assurance on devolved tax forecasts and related fiscal issues from 2015-16. This role would of course expand considerably in the event of a vote for independence in September 2014. The Scottish Government’s response to each of the Committee’s recommendations is provided below.

Principles

8. The committee recommends that it is essential that the SFC should be independent and be seen to be so.

9. The committee recommends that the SFC adheres to the 22 OECD principles and in particular, the principles of independence, non-partisanship and transparency.

The Scottish Government agrees with these recommendations. It believes that the independence of the SFC is essential in establishing and maintaining its credibility and therefore its ability to give assurance on the integrity and reasonableness of fiscal forecasts. The Scottish Government intends to establish the SFC on a statutory basis as soon as reasonably possible, at which point there will be opportunity for the Committee to satisfy itself that the draft legislation provides satisfactory safeguards on independence and on other elements of the OECD principles. In the meantime, the Scottish Government intends that the SFC will function on a non-statutory basis, adhering to the same principles.

Role and Remit of a Scottish Fiscal Commission

32. With regards to the role and remit of the SFC, the Committee recommends:

- The Scottish Government should consider the option of inviting the SFC to produce the official macro-economic and fiscal forecasts for Scotland;

- however, if the remit is to provide a commentary on Scottish Government forecasts, it is essential that to ensure its independence, the SFC should have no role in producing the forecasts;

- the remit should include the option to develop its own forecasting method and analytical capacity in order to provide a benchmark set of projections.
the role and remit should be clearly set out in legislation with further details in relation to how these are fulfilled set out in a Charter;

the role and remit should be considered following any further extension of the Parliament's fiscal powers.

The Scottish Government believes that responsibility for carrying out economic and fiscal forecasts, including tax receipt forecasts, should lie with the Scottish Government and that primary accountability should be of Ministers to the Parliament. This is consistent with the accountability of Ministers for economic and fiscal policy, to the limited extent that these are presently devolved. However the Government strongly believes that to provide maximum assurance to the Parliament, all forecasts should be subject to independent scrutiny by the SFC, with public reporting on that scrutiny. It believes that this approach will ensure robust and transparent forecasting and will assist the Parliament in holding the Scottish Government to account in as effective a way as possible.

The Scottish Government notes that the Fiscal Commission Working Group took the view that a Scottish fiscal body should have relative responsibilities along these lines, and that the evidence provided by the OECD to the Finance Committee on its survey of independent fiscal commissions suggests that the remit of many such bodies is to assess fiscal forecasts produced by governments.

The Scottish Government agrees that the SFC should have no role in producing the original forecasts. It intends to set this out in establishing the remit of the body, on a non-statutory basis for an interim period and on a statutory basis in due course.

Against that background the Scottish Government does not expect that the SFC would need to develop its own forecasting methods or to have its own analytical capacity in order to provide a benchmark set of projections. However the SFC will need access to analytical capacity to enable it to scrutinise and evaluate economic and fiscal modelling undertaken by the Scottish Government, and to report on its conclusions. The need for analytical capacity will be discussed and agreed with members of the SFC once identified. The capacity required to scrutinise receipts forecasts should be proportionate to the fact that under present arrangements 2 taxes supporting about 1.5% of the Scottish Government's budget are devolved. The SFC will be given full access to all economic and fiscal forecasting models used by the Scottish Government to support its audit and assurance work and to enable the SFC to undertake its own sensitivity analysis.

The Scottish Government agrees that the remit of the SFC should be set out in legislation in due course, and that the legislation should require that a Charter should be put in place. In the meantime, the Scottish Government intends to set out in writing an interim remit for the SFC and to discuss and agree this with the Finance Committee, on the basis that the remit will be developed, amended and agreed as appropriate as further responsibilities are added.

The Scottish Government therefore agrees that the role and remit should be reviewed and adjusted following any further extension of the Parliament's fiscal powers.
As the OBR produces Scottish tax forecasts twice a year, the SFC should also provide a commentary twice a year which should include the views of the SFC on the economic determinants underpinning the tax revenue forecasts.

The Scottish Government believes that the SFC should undertake scrutiny and provide commentary and assurance to a timetable and with a frequency that best suits the Scottish budgeting cycle and supports the work of the Parliament in holding Ministers to account on fiscal issues. In adjusting the Written Agreement governing the budget scrutiny process between the Scottish Government and the Finance Committee, it has already been agreed that the SFC will provide a commentary to the Parliament either as part of or alongside the draft Budget document each autumn. The Scottish Government would be willing to discuss with the Committee and with the members of the SFC once identified whether further reporting by the SFC on updated tax receipt forecasts would be appropriate, in the first and in subsequent years of operation. The Scottish Government is clear that the timetable for SFC reporting should be revisited and adjusted as necessary following any further extension of the Parliament’s fiscal powers.

The SFC should also be asked to comment twice a year on the Scottish Government’s forecasts for NORI including the economic determinants underpinning the forecasts.

The Scottish Government agrees with this recommendation, subject to the caveats noted below. It will be valuable for the Parliament to have SFC comments on the assumptions relating to economic determinants underpinning NORI forecasts such as buoyancy and future business rate poundage (normally linked to RPI inflation). However there are other factors used in NORI modelling such as assumptions about bad debts and appeals losses. These are commercial assumptions which are based on experience and on assessments made within SG and by local authorities. It is less clear that the SFC will have expertise in these areas. The Scottish Government would propose to discuss these relatively detailed issues further with the members of the SFC once identified. There should also be an opportunity for the Finance Committee to review and to satisfy itself about the approach which the SFC proposes to take to the issue of assuring NORI forecasts.

The economic determinants underpinning NORI forecasts are taken from annually published figures (including inflation forecasts from the OBR, the Poundage rate, tax base as per the Valuation Roll on 1 April and end year appeals losses). The Scottish Government proposes that the SFC should comment annually on NORI forecasts at the time of the publication of the draft Budget document.

The Scottish Government has a statutory duty to compile and publish an annual Non-Domestic Rating Account (known as the White Paper) which is laid before Parliament. The aim of this paper is to provide transparency and opportunity for further Parliamentary scrutiny. The paper records all NDRI collected and distributed for the year in question.
Forecasting of SRIT receipts

36. The Committee notes that under the current arrangements HMRC will produce the revenue forecast for SRIT based upon economic determinants provided by OBR. It is not clear, therefore, what role, if any, the SFC or Scottish Government will have in producing or commenting on the revenue forecast for SRIT.

37. The committee asks the CSFESG to explain what the role of the Scottish Government and SFC will be in relation to the forecasting of SRIT revenues and whether there has been any discussion with HMRC and OBR regarding how this will work in practice.

The Scottish Government has agreed with the Finance Committee that the Written Agreement will be revisited in the course of 2014 with a view to making adjustments relevant to the introduction of SRIT with effect from April 2016, under current constitutional arrangements. The Scottish Government therefore expects to discuss respective roles and responsibilities in detail with the Finance Committee over the next 6 months or so. This would include forecasting responsibilities.

SRIT is not a devolved tax. It will be administered by HMRC, and receipts will be collected and accounted for by HMRC. HM Treasury will use forecasts of Scottish rate receipts prepared by HMRC and OBR to calculate the Scottish block grant. Given these arrangements, the role of the SFC and indeed of the Scottish Government in reviewing Scottish rate receipts forecasts is unlikely to be major.

During the transitional period of 2 or 3 years beginning in April 2016, the forecasts will not affect the Scottish budget since the same forecasts will be used both to calculate the amount to be added to the block grant in respect of SRIT receipts and to adjust the block grant downwards to reflect the fact that this income will no longer be available to HM Treasury. Consequently the risks to the Scottish budget are limited during that period.

As indicated in the Cabinet Secretary’s letter of 8 January 2014 to the Convenor of the Finance Committee on progress with implementing the 2012 Act provisions, with particular reference to the Scottish rate and the associated block grant adjustment, further discussions will be held with the UK Government about the administration of the Scottish rate and the block grant adjustment prior to implementing the Scottish rate from April 2016.

Against that background, the Scottish Government proposes to review and consider adjustments to the remit of the SFC as appropriate prior to April 2016 to take account of the introduction of SRIT. This would cover review of OBR forecasts, and arrangements for obtaining access to necessary data. Any such proposals would be discussed with the Finance Committee, and also with the members of the SFC, before they were introduced.
Access to Data and Information

45. The Committee recommends that the SFC should have a right of access (at any reasonable time) to all Scottish Government and Revenue Scotland information and analytical capacity which it may reasonably require for the performance of its duty. The right of access should be established on a statutory basis and the detail set out in a MoU.

46. The Committee recommends that it is essential that any contact between the SFC and the Scottish Government and Revenue Scotland should be based on a transparent framework of co-operation. The basis of the working relationship should be set out in a MoU.

47. The MoU should include the procedure and timings for the SFC to submit its views to the Scottish Government on its provisional forecasts (prior to publication) and the procedure and timings for dealing with any differences of opinion. It is expected that such views will be made publicly available.

48. The Committee recommends that given the OBR will continue to carry out the UK wide forecasts a MoU is agreed between the OBR and the SFC.

49. The Committee also recommends that if the SFC will have a role in forecasting SRIT revenues then it will require a similar right of access to all HMRC information and analytical capacity which it may reasonably require for the performance of its duty. This should be set out in a MoU between HMRC and the SFC.

The Scottish Government agrees with recommendations 45, 46 and 47. In the interim period before the SFC is placed on a statutory footing, it is proposed to prepare a MoU for agreement among SG, the SFC, and Revenue Scotland setting out respective responsibilities and relationships. The MoU would be discussed with the Finance Committee in draft, as well as with members of the SFC.

The Scottish Government also agrees that a MoU should be agreed between the SFC and the OBR (recommendation 48). It is intended to discuss the coverage of this with the members of the SFC once identified and thereafter with the OBR.

The Scottish Government believes that the issue of whether a MoU should be agreed between SFC and HMRC (recommendation 49) should await further consideration of respective roles in relation to the Scottish rate. Where required, the Scottish Government will seek the agreement of the UK Government to SFC having access to all information and analysis it needs to undertake the work required by Scottish Ministers.

Relationship with the Government and Parliament

53. The Committee notes that the level of accountability of the SFC to the Scottish Government is very much dependent on its role and remit. In particular, it is dependent on the role which the SFC may have in relation to the Scottish Government forecasts prior to publication.
54. The Committee recommends that all reports which the SFC produces should be laid before the Scottish Parliament.

The Scottish Government believes that the SFC should be primarily accountable to the Parliament through reports on its work of scrutinising Scottish Government tax forecasts. If this scrutiny work highlights a sustained difference of view between SG and the SFC on tax receipts forecasts or any other matters, the Scottish Government will either adjust its forecasts or explain why it has decided to adhere to them.

Information about the SG's forecasts and about SFC's scrutiny would be published in the context of the draft Budget. The SFC would be directly accountable to the Parliament through the chair and members being available to give evidence for example to the Finance Committee on receipts forecasts.

Appointment process

60. The Committee recommends that all members of the SFC are appointed by Ministers under the provisions of the Public Bodies and Public Appointments etc. (Scotland) Act 2003 but that the appointments should also be subject to the consent of the Parliament on the recommendation of the Finance Committee. The Finance Committee should also have the option to hold a pre-appointment hearing and will be required to report to the Parliament.

Length of Appointment

63. The Committee recommends that under the existing constitutional arrangements there should be 3 part-time members of the SFC appointed for normally no more than 5 years for a single term whose appointment cannot be terminated without the consent of the Parliament on the recommendation of the Finance Committee. The initial terms should be staggered to ensure some continuity within the SFC and the appointment process should always be separate from the political cycle.

The Scottish Government agrees with these recommendations, which it believes will contribute to the independence of the SFC and therefore its credibility and authority. The formal appointments process cannot take effect until primary legislation is enacted. In the interim period prior to enactment of legislation, the Scottish Government proposes to proceed by analogy and to submit proposals for non-statutory appointments to the Finance Committee for review and approval. In due course, when a Bill is prepared, the Scottish Government intends that its provisions should reflect the Committee's recommendations on appointments processes and periods.

Resources

67. The Committee recommends that the funding for the SFC should be allocated on a multi-year basis within the Spending Review period and should have a separate level 3 budget heading in the Draft Budget.
Staffing

70. The Committee welcomes the confirmation of the CSFESG that the SFC will have the ability to appoint its own staff.

In the interim period before the SFC is established on a statutory footing, it would not be appropriate to allocate resources within the Scottish Government's budget, nor to give the members of the SFC who are appointed in the interim the power to appoint staff. Once legislation has been enacted, it is the SG's intention that both budgets and staffing should be settled as the Committee has proposed. During the interim period, Ministers will agree with the members of the SFC, once identified, what arrangements they wish to pursue in terms of staffing and other resources. The Scottish Government's intentions would be to make available a modest budget of about £20,000 annually to cover resource costs which might be provided for example from a University economics department in reviewing forecasts associated with the two taxes devolved under present arrangements. In the interim period, costs incurred by the SFC and met by the Government would be reported annually to the Finance Committee. Following enactment of the relevant legislation, this information would be provided in the SFC's annual report and accounts.

External Evaluation

72. The Committee recommends that the Scottish Governments sets out the arrangements for external evaluation of the work of the new fiscal body by an appropriate independent expert organisation.

The Scottish Government agrees with this recommendation. Officials will consider and bring forward proposals in due course, following discussion with the members of the SFC.

Conclusions

73. The Committee very much welcomes the Scottish Government's proposals to establish an independent SFC. The Committee recognises that the initial scale and role of the new body needs to be proportionate with the current constitutional arrangements. However, at the same time, it is essential that the role and remit is sufficient to ensure that the SFC can operate independently of the government.

The Scottish Government agrees with this conclusion and reaffirms its support for the independence of the SFC to ensure credibility and authority.

74. The Committee notes that there are currently no other organisations within Scotland providing independent fiscal and macro-economic forecasts and the Scottish Government may wish to consider allocating this role to the SFC.
The Scottish Government will continue to keep this matter under review. It believes that final decisions should be made in the light of constitutional developments.

75. The Committee also welcomes the commitment to bring forward legislation to establish the SFC on a statutory basis and invites the Scottish Government to consider the findings of this report in drafting the Bill and in drawing up the interim measures for the operation of the SFC.

The Scottish Government accepts this recommendation and will keep the Finance Committee informed of progress in developing interim arrangements and in preparing to draft a Bill.

Scottish Government
April 2014